the INTANGIBLES TAX STUDY COMMISSION

REPORT
TO THE
GOVERNOR
AND THE
1979
GENERAL ASSEMBLY OF NORTH CAROLINA

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LETTER OF TRANSMITTAL

January 1, 1979

TO THE GOVERNOR AND THE 1979 GENERAL ASSEMBLY:

Transmitted herewith is the final report of the Intangibles Tax Study Commission. The Study was conducted pursuant to House Joint Resolution 1691 (ratified Resolution 128) of the 1977 General Assembly, Second Session 1978, and the recommendations contained in this report were adopted at the final meeting of the Commission held on December 11, 1978.

Respectfully Submitted,

Waverly F. Akins

Waverly F. Akins, Chairman
Intangibles Tax Study Commission

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INTRODUCTION AND COMMISSION PROCEEDINGS

House Joint Resolution 1691 (ratified Resolution 128) of the 1977 General Assembly, Second Session 1978, established the Intangibles Tax Study Commission. The Commission was directed to "make a thorough study of the tax levied on intangible personal property by Schedule H of the Revenue Act (G.S. 105-198 through 105-217) and recommend any changes in the tax that it deems necessary." Section 3 of the Resolution gives more specific directions as follows:

> The Commission shall give particular attention to the effect of this tax on the overall equity of the State-local tax system in North Carolina and its effect on the State's economy. If the Commission should recommend that the tax be repealed or reduced, it shall also consider the issue of alternative sources of revenue for local governments now receiving a share of the intangibles tax proceeds and the issue of other funding for items in the State budget now supported by the intangibles tax.

Pursuant to House Joint Resolution 1691, the Intangibles Tax Study Commission was appointed and its first meeting was held on September 7, 1978 (a copy of House Joint Resolution 1691 and a list of Commission members may be found in Appendix I).

Much of the first meeting was devoted to organizational matters. Mr. Waverly Akins was elected Chairman of the Commission and Senator Russell Walker was elected Vice-Chairman. A planning budget for the study was adopted. Mr. Frank Goodrum, Director of the Intangibles Tax Division of the Department of Revenue provided each member of

the Commission with a package of materials relating to the intangibles tax and made a brief presentation on the history of the tax.

Mr. Ernie Ball, General Counsel to the North Carolina League of Municipalities, and Mr. Ron Aycock, Executive Director of the North Carolina Association of County Commissioners, were asked for any comments they might wish to make. Both men stated that the local units of government could not afford the loss of revenue which would result from a simple repeal of the intangibles tax. They urged the Commission not to recommend repeal unless replacement of the revenue loss was also recommended.

The Commission concluded that an assessment of the economic impact of the tax on intangible personal property would be invaluable during future deliberations. The staff was directed to solicit input from various organizations which deal with the intangibles tax. Each of these organizations, such as the North Carolina Bankers Association and the North Carolina Savings and Loan League, was asked to evaluate the impact of the intangibles tax on the segment of the society which that organization represents (a copy of the letter and a list of the organizations to which it was sent is contained in Appendix II).

The Commission's second meeting was held on October 10, 1978 in the Legislative Building in Raleigh and several speakers made presentations at this meeting. The first was Dr. John O. Blackburn of the Department of Economics at Duke University.

Dr. Blackburn stated his general support for retention of the intangibles tax, noting its highly progressive nature. He suggested that the Commission might wish to consider the impact that the tax has on some isolated segments of the society, such as the retired population. With regard to this group, he noted that Florida imposes a lower tax rate on intangibles than does North Carolina.

The next presentation was made by Mr. Ken Flynt, Economic Advisor to the Governor. Mr. Flynt presented a series of questions to be answered concerning proposed repeal of the intangibles tax. The first question was how much of a deterrent to potential residents of the State is the intangibles tax? Assuming that the tax is something of a deterrent, it is extremely difficult to ascertain the extent of this deterrence. Mr. Flynt next urged the Commission to consider how the lost revenue would be replaced were the tax to be repealed. He noted that Proposition 13 had created a very bad climate for the introduction of new taxes or the increase of existing ones. Finally, Mr. Flynt stated that if the tax were repealed and replacement revenue distributed to the local units of government, some mechanism for distribution would have to be developed.

Appearing on behalf of the North Carolina Bankers Association was Mr. Thomas A. Sanders, Jr., Senior Vice President of Wachovia Bank and Trust Company. Mr. Sanders spoke in opposition to the tax and explained the various ways in which administration of the tax is a burden to banking institutions.

Mr. Goodrum was called upon to present a survey he had conducted of various states which had repealed their intangibles tax. Mr. Goodrum had conducted the survey at the Commission's request. The survey indicated that few of the states which had repealed the intangibles tax had ever produced significant revenues with the tax. Also, many of these states allowed local governments to tax intangibles directly, which produced numerous administrative difficulties.

Mr. Dave Crotts, Fiscal Research Division, gave a summary of the responses received from the various organizations as a result of the letter sent out at the Commission's direction at the first meeting. Although the Commission had requested as much quantitative data as possible concerning the economic impact of the tax, few of the respondants were able to provide such data.

The third meeting of the Commission was held on November 21, 1978. The Commission heard comments from a number of persons who had attended the meeting with viewpoints they wished to express. Mr. W. F. Voigt and Mr. Clyde Harmon appeared individually to urge repeal of the tax because of its serious impact on retired persons living on fixed incomes.

Mr. Otto Koester representing the People's Alliance, and Mr. Lawrence Morse representing the North Carolina Consumers Council, both spoke in opposition to repeal of the tax. They indicated that their organizations found the intangibles tax to be a sound and equitable portion of the North Carolina tax structure. They

indicated, however, that their organizations would support relief for the elderly.

Mr. A. E. Britt of the North Carolina A.F.L.-C.I.O. stated that it would be more appropriate to remove the sales tax from food than to repeal the intangibles tax.

Mr. Crotts had developed, at the direction of the Commission, a number of proposals which showed projected losses of revenue from various changes in the intangibles tax. The Commission discussed the various proposals and directed the staff to work out more detailed proposals for review at the next meeting providing for total repeal of the tax as well as more limited relief for the elderly.

The fourth Commission meeting was held on December 11, 1978. The Commission received a staff report outlining the revenue consequences of several types of limited relief from the intangibles tax. The Commission discussed briefly the idea of transferring the portion of the intangibles tax paid by the business community to the franchise tax. In light of the broader recommendations adopted, this concept was not made part of the recommendations. Having adopted the final recommendations contained in this report, the meeting was adjourned and the Commission was dissolved.

FINDINGS

The Intangibles Tax Study Commission, after considering the presentations made before it and evaluating the information and data it has gathered, makes the following findings:

1. The intangibles tax has a negative impact on the economy of North Carolina.

The Commission made every effort to assess the economic impact of the intangibles tax, however, little quantitative data was available. Many of the representatives of financial institutions which contributed information indicated an awareness of persons and companies which had chosen not to reside or invest in North Carolina because of the existence of the tax on intangible personal property. Very seldom, however, is it possible to ascertain the size of an investment which is not made. Further, when a corporate decision to locate or invest elsewhere than North Carolina has been made, similar decisions by corporate personnel may well follow. Such lost investments could be quantified only in the most speculative terms.

While the extent of the deterrent effect of the intangibles tax is difficult to ascertain, the existence of the deterrent effect itself is manifest. North Carolina is in competition with the other states, especially the other southeastern states, in the attraction of residents and investments. There are certainly advantages to

locating in North Carolina which will attract individuals or corporations to reside or invest in North Carolina instead of another state. When the decision is close, however, and all other factors as perceived by the decision-maker are equal, the intangibles tax may well lead to a determination adverse to North Carolina.

2. <u>The intangibles tax imposes a serious burden on elderly persons living on fixed incomes</u>.

For many of North Carolina's elderly citizens, interest from savings and dividends from investments form their only income. Income tax is paid on the money derived from these sources, and the payment of the intangibles tax often requires liquidation of assets and a consequent reduction of income. Forcing reduced income on any segment of our population during a prolonged period of inflation creates an economic crisis for those persons.

The Commission has noted that there is significant relief available for elderly persons with low incomes from the tax on real property, but the elderly who have intangible investments instead of investments in real property must pay the intangibles tax. In considering retirement locations, the intangibles tax makes North Carolina an unattractive choice to many elderly persons. Because these retirees do not locate or invest in North Carolina, the State also misses out, eventually, on the inheritance taxes from their estates.

3. <u>The intangibles tax is seen by many people as a "nuisance" tax</u>.

It was frequently stated by many of the persons speaking before the Commission that the most onerous aspect of the intangibles tax is its nature as a "nuisance", rather than the financial burden created by the tax. This problem most clearly exists for the banking institutions in North Carolina which have had to undertake a significant amount of the administration of the tax.

Because the tax rate is low, but the administrative effort is the same regardless of the size of the taxpayer's account, banks spend a large amount of time dealing with a small amount of tax revenue. This inefficiency is troublesome and has brought about some of the most vehement opposition to the tax.

4. The tax base of the local units of government could not afford the erosion that would be brought about by repeal of the intangibles tax without replacement of the revenue.

From the very outset of the study, the Commission sought the views of the representatives of the local units of government concerning the intangibles tax. The approximately $35 million derived from the intangibles tax is important to the local units of government. If this source of funds were removed, local officials would be forced to increase the rates applied to other forms of property. Increases in local property taxes are seen as especially unwise in light of the "taxpayers' revolt" taking place in many parts of the country following the passage of California's Proposition 13.

The Commission has found that the pressure on the local tax base which would be created by a repeal of the intangibles tax to

be unreasonable. It would unduly handicap the counties and cities in their efforts to provide services to their citizens. The Commission therefore finds that any revenues lost by the local units of government as a result of changes in the intangibles tax should be replaced by the State.

RECOMMENDATIONS

The Intangibles Tax Study Commission, after a complete review of the data it has collected, and in light of the findings it has made, makes the following recommendations·

1. The tax on intangible personal property should be repealed and intangible personal property should be classified and excluded from the local property tax base. (The fiscal analysis of this proposal is contained in Appendix III.)

The Commission has found that the negative aspects of the intangibles tax far outweigh the benefits derived from it. Although the immediate means for replacing the revenues for the local units of government will be discussed in Recommendation 2 below, the Commission feels that the loss of revenue, in the long range view, will be more than recovered through other taxes on the increased commercial activity which will be generated by repeal of the tax.

The Commission also found the impact of the tax on retired persons living on fixed incomes to be unjustifiable. The tax deters people from locating in North Carolina upon retirement and thereby deprives the State of future inheritance taxes.

In general, the Commission found the intangibles tax to be extremely unpopular in North Carolina. While no one likes to pay taxes, it is clear that there is widespread acceptance of most taxes and an understanding that governments must accumulate the

money required to provide essential services. Many persons, however, find the intangibles tax to be uniquely burdensome, seeing it as resulting in the multiple taxation of the same wealth. The Commission is aware of the prevailing trends in this country concerning reduction of taxes and the limitation of government expenditures. It seems most appropriate to repeal the intangibles tax in view of its widespread unpopularity and overall adverse economic impact.

Simply repealing the current intangibles tax law would, by virtue of general constitutional property taxing powers, enable local units of government to tax intangible personal property directly. To avoid such an occurrence, the Commission recommends the classification of intangible personal property and exclusion from the property tax base. There are numerous examples of such excluded classes of property in the Machinery Act.

2. <u>The franchise tax on private corporations should be increased and the resulting revenues should be distributed to the local units of government to replace the revenues from the intangibles tax</u>.

The Commission feels that the business community in North Carolina will be the beneficiary of much of the increased commercial activity which will result from the repeal of the intangibles tax. It is therefore appropriate that the business community be turned to for the replacement of lost revenues. Many public

utilities are subject to the franchise tax in North Carolina, but as these are regulated industries, the Commission does not propose to include them in the application of the increased franchise tax.

The franchise tax is found in Article 3 of Chapter 105 of the General Statutes. G.S. 105-122 deals with the franchise tax on domestic and foreign corporations. Subsection (d) provides for a tax at the rate of $1.50 per $1,000 of capital stock, surplus and undivided profits as set forth elsewhere in that section. The Commission recommends enactment of a new subsection (d1) which would apply a surtax to these corporations. Preliminary revenue estimates indicate that the amount of the surtax will have to be approximately $1.25 per $1,000 to generate sufficient funds to replace intangibles tax revenues.

The revenue generated from the franchise surtax would be distributed directly to the local units of government by the Department of Revenue just as it has been distributing the intangibles tax proceeds. The formula for distribution is discussed in Recommendation 3 below.

3. Funds to replace the intangibles tax revenues should be distributed to the counties in the same proportions as they received under the final distribution of intangibles tax proceeds, and apportioned within each county according to ad valorem tax levies.

Development of a reasonable formula for distributing the replacement revenues to the local units of government was one of

the most significant matters to be dealt with by the Intangibles Tax Study Commission. The approach used under the intangibles tax was a combination of returning some funds to the counties in which the funds were collected and distributing the rest to the counties based on their respective populations. The money then would be divided among the county and all the municipalities within it based on the ad valorem tax levies for the preceding fiscal year.

The Commission wanted to develop a distribution mechanism which would track as closely as possible that which has been used in the past. It was therefore decided to distribute the funds to the counties in the same proportions as they receive under the final intangibles tax distribution. Within each county, the method will remain the same as under the current intangibles tax, utilizing ad valorem tax levies from the preceding year.

Some consideration was given to basing the initial distribution to counties solely on population. This approach, however, has the disadvantage of ignoring the part of the intangibles tax which is returned to the counties in which it is collected. For the first few years, the distribution recommended here will be very close to what would have occurred under the intangibles tax. As time goes on, it will admittedly be less precise.

The Commission feels that the failure of this proposed distribution mechanism to reflect changes in population will be somewhat offset by the increased amount of revenues to be shared. The

growth rate of the franchise tax has been higher in the past than that of the intangibles tax. If this trend continues, there will be more money to share among the local units of government than there would have been under the intangibles tax. Hopefully, this will put all local units in a more beneficial position than they would have enjoyed had the intangibles tax not been repealed.

ALTERNATE RECOMMENDATION

There was serious concern within the Commission about the recommendations set forth above in that several members felt that the General Assembly would not view favorably so large an increase in the franchise tax to replace the revenue loss created by repeal of the intangibles tax. The extent of this concern is shown by the vote by which those recommendations were adopted: four members voted for the recommendations and three, against. Although the majority of the members felt that the increase in the franchise tax was justified, the Commission decided to offer an alternative recommendation to the General Assembly. The following recommendation was approved by a vote of six to one:

Limited relief from the intangibles tax should be granted by exempting all persons sixty-five years of age or older or totally and permanently disabled, and by excluding all money on deposit.

Should complete repeal of the intangibles tax not be possible, the Commission feels that at least the two most unfair and unpopular aspects of the tax should be deleted from the law. As set forth in the findings (see Finding #2), elderly persons most seriously feel the burden of this tax. By exempting persons sixty-five or older, the State will not only alleviate the hardship currently being endured by the elderly in North Carolina, but it will also encourage persons to select North Carolina as a retirement home. The economic

benefits from increased inheritance tax revenues would at least partially offset the loss of revenues from this exemption from the intangibles tax. The Commission recommends that this exemption be extended to permanently and totally disabled persons as their economic situation parallels closely that of the elderly.

The second aspect of the tax which the Commission feels should be deleted is its applicability to money on deposit. It has already been noted that a large part of this tax's unpopularity can be traced to its characterization as a "nuisance" tax. The tax on money on deposit is a nuisance to both taxpayers and financial institutions alike. The financial institutions are required to expend significant amounts of administrative time for what frequently turns out to be small amounts of revenue. The Commission feels that deletion of this segment of the intangibles tax would satisfy some of its most vehement opponents.

The Commission recommends that the revenue lost as a result of these changes be recovered through the same mechanism described in the primary set of recommendations, increasing the franchise tax. As the total revenue loss would be approximately half that caused by a complete repeal, a smaller increase in the franchise tax would be required. An increase of 60¢ or 65¢ per $1,000 would probably be sufficient.

APPENDIX I

GENERAL ASSEMBLY OF NORTH CAROLINA

1977 SESSION (2nd SESSION, 1978)

RATIFIED BILL

RESOLUTION 128

HOUSE JOINT RESOLUTION 1691

A JOINT RESOLUTION TO ESTABLISH THE INTANGIBLES TAX STUDY COMMISSION.

Be it resolved by the House of Representatives, the Senate concurring:

Section 1. There is established the Intangibles Tax Study Commission. The commission shall consist of the State Treasurer, the Secretary of Revenue, the Chairman of the Economic Development Board within the Department of Commerce, three citizens appointed by the President of the Senate and three citizens appointed by the Speaker of the House of Representatives. The chairman of the commission shall be elected by the members of the commission from among their number. The commission may also elect such other officers as it deems necessary.

Sec. 2. The President of the Senate and the Speaker of the House of Representatives shall make their appointments on July 1, 1978, or as soon thereafter as is practicable. Members shall serve until the report of the commission is filed with the Governor and the General Assembly.

Sec. 3. It shall be the duty of the commission to make a thorough study of the tax levied on intangible personal property by Schedule H of the Revenue Act (G.S. 105-198 through

105-217) and recommend any changes in the tax that it deems necessary. The commission shall give particular attention to the effect of this tax on the overall equity of the State-local tax system in North Carolina and its effect on the State's economy. If the commission should recommend that the tax be repealed or reduced, it shall also consider the issue of alternative sources of revenue for local governments now receiving a share of the intangibles tax proceeds, and the issue of other funding for items in the State budget now supported by the intangibles tax.

Sec. 4. The commission shall report its findings and recommendations to the Governor and the 1979 General Assembly, and shall make publication of the same not later than January 1, 1979.

Sec. 5. The members of the commission shall receive per diem, travel, and subsistence allowances in accordance with the provisions of G.S. 138-5.

Sec. 6. The expenses of the commission shall be paid from the Contingency and Emergency Fund pursuant to the procedure prescribed by or pursuant to law. The commission is authorized to accept and expend the proceeds of any gift, donation, or grant from any person, firm, corporation, foundation, or governmental agency to defray the costs of performing its duties. The commission may employ such assistance and procure such materials and services as it deems necessary to the performance of its duties. Every agency of State, county, and municipal government shall provide the commission with such information and assistance as it shall request.

Sec. 7. This resolution is effective upon ratification.

In the General Assembly read three times and ratified, this the 16th day of June, 1978.

JAMES C. GREEN, SR.

James C. Green

President of the Senate

CARL J. STEWART, JR.

Carl J. Stewart, Jr.

Speaker of the House of Representatives

INTANGIBLES TAX STUDY COMMISSION

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APPENDIX II

NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE SERVICES OFFICE
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September , 1978

CLYDE L. BALL
LEGISLATIVE SERVICES OFFICER
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Name and address

Dear Mr. :

As we discussed on the telephone, the Intangibles Tax Study Commission, organized pursuant to H.J.R. 1691 (Ratified Resolution 128) of the 1977 Session Laws, Second Session 1978, held its first meeting on Thursday, September 7, 1978, in the Legislative Building in Raleigh.

At this organizational meeting, the Commission identified the need to determine the economic impact of the intangibles tax as a major objective of their study. The staff was directed to contact a number of organizations, including yours, to solicit written statements of those organizations evaluation of the economic impact of the intangibles tax on the sector of the community they represent. It is important to stress that the Commission specifically does not want broad, general expressions of support or opposition to the taxation of intangible personal property. The Commission is seeking data which will enable it to evaluate the current economic impact of the tax and generate meaningful estimates of the effect of its repeal or alteration.

Below is a list of questions. In order that the responses we receive from the various organizations be amenable to compilation and analysis, we request that, where feasible, your statement be addressed to the specific questions posed.

1. Does the payment or collection of the intangibles tax present a burden to the members of your organization? What is the nature of the burden? Can you ascribe figures to the cost of this burden?

2. Based on day-to-day experiences and conversations, do you believe that the intangibles tax keeps any persons or businesses from locating or investing in North Carolina? Do you have financial estimates of lost investments? Do you have examples of negative location or investment decisions attributable to this tax?

3. Would the repeal of the intangibles tax bring additional residents or investments to North Carolina? Do you have any estimates of the extent of new investments or residents that repeal might generate?

Some of these questions may be inappropriate for your organization. Please indicate when that is the case. Also, feel free to add any additional information which you feel would be useful to the Commission, especially relevant figures generated by your organization or its members.

The next meeting of the Intangibles Tax Study Commission is to be held on Tuesday, October 10, 1978, at 2:00 P.M., in Room 1405 of the Legislative Building. We would appreciate your response as soon as possible, but in no event will we be able to incorporate into our analysis responses received later than September 29, 1978.

We understand that the information we are soliciting from you is not easy to compile and will require significant effort on your part. On behalf of the Commission, I would like to express our appreciation for your willingness to assist this important and complex endeavor. You are certainly welcome to attend any of the Commission's meetings and, before the study is completed, the Commission hopes to receive presentations from all persons interested in appearing.

Once again, many thanks for your cooperation.

Sincerely,

Paul H. Stock
Committee Counsel

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APPENDIX III

Explanation of Proposal:
Full repeal of intangibles tax with revenue loss to be made up by increase in State franchise tax on corporations. Distribute tax collections back to counties and cities on basis of allocation formula based on 1978-79 distribution.

Estimated Fiscal Effect:

Assumed effective date January 1, 1979

Fiscal Year	Revenue Gain
1979-80	$ 0
1980-81	2,150,000
1981-82	5,400,000
1982-83	9,100,000

(1) The revenue gain occurs from the fact that State franchise tax revenues grow at a faster rate than intangibles tax collections. As a matter of fact, in some years there is a decline in intangibles tax collections.

(2) Even though North Carolina's population is exceeded by 11 other states and our corporate franchise tax base is probably exceeded by at least 15 other states, our total corporate franchise tax collections are the fourth highest in the U. S. This means that our tax rate for an individual corporation has to be considerably larger than that of almost all other states.

(3) The proposal does not deal with the franchise tax on public utilities. Actually this tax, though it is called a franchise tax, is not a corporate franchise tax but is a public utility excise, or gross receipts, tax.

(4) To the extent that corporations are able to pass on the tax increase to their consumers, the proposal would shift the tax burden from wealthy individuals owning intangible personal population to consumers at all income levels. Of course some of the additional franchise tax would be exported to consumers in other states.